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**“Expiring Tax Incentives: Examining their Importance for Small
Businesses on the Road to an Economic Recovery”**

House Committee on Small Business

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Introduction

The economic recovery continues. Today, as always, small business leads the charge in creating new jobs that stimulate the economy, claiming as much as 80% of all net new jobs in this country. The Administration, legislators on both sides of the aisle, short and long term economists, and virtually every other source point to small business as *the* sector of our economy that leads all others in job creation and therefore, the key stimulus factor in continuing the economic recovery vital to all sectors of our country.

The Joint Committee on Taxation has provided a list of over 25 major tax incentives that are scheduled to expire in 2009, and further, there are over 85 temporary tax incentives that have been extended from year to year that are scheduled to expire or “sunset” by the end of 2010. Many of those provisions were enacted over time by Congress to stimulate business and job growth and have been successful particularly for small businesses across the country. Congress certainly could not have anticipated the economic crisis that we all are currently facing, however, now is not the time to end key tax incentives that have contributed to the creation of new jobs. The National Association for the Self-Employed (NASE) is strongly in support of extending tax incentives that are currently scheduled to expire. In particular, the NASE supports extending the provisions for Alternative Minimum Tax increased exemption amounts, bonus depreciation options, section 179 limits, the sales tax deduction option, the first time home buyer’s credit, and 15 year cost recovery for certain qualified leasehold improvements and five year recovery for farming business machinery and equipment.

There are certainly many other provisions that have made a significant difference in helping American citizens through troubled times that deserve to be extended as well. Education incentives, charitable contribution incentives, educator incentives, required IRS distribution options for certain retirement plans, among others have all made a difference and provided relief for taxpayers. The country finally seems to be able to see a light at the end of the tunnel, and taking away tax incentives that clearly have made a difference for many Americans seems to be the wrong signal at the wrong time.

Although each of these provisions deserves its own discussion, the National Association for the Self-Employed would like to highlight some of the key provisions scheduled to expire that will have a significant impact on small businesses, particularly the smallest of those businesses, micro-businesses.

Alternative Minimum Tax exemption amount:

The Alternative Minimum Tax (AMT) was enacted over four decades ago to remedy a unique situation in the tax code, namely that a few of the wealthiest taxpayers paid no tax at all. In times of tough choices and budget constraints at all levels, the idea of the wealthiest Americans and those with the highest earnings paying no taxes certainly seems like a loophole that should be closed. However, in 2009 the AMT affects more Americans than was ever intended and affects almost all small business owners even if no tax results from the additional calculation. The basic premise of the AMT system is that

all people should pay their fair share, so the AMT provides for an alternate tax calculation that eliminates many deductions, exemptions and credits so that all taxpayers pay some tax. Again, the original idea was to prohibit those taxpayers with the most resources at their disposal from taking advantage of “loopholes” in order to avoid tax altogether. However, the effects of inflation, the time value of money, the growth of earnings and expenses was not taken into account. Therefore, today small business owners and families who never had the resources to seek out loopholes or to avoid tax liability find themselves subject to AMT due to the fact that the exemption amount embedded in the AMT calculation was never adjusted for inflation. Congress has recognized that inequity and has adjusted the exemption amount over time to keep up with inflation. That increase in the exemption amount is now scheduled to end. Allowing that inequity to resurface would cause an unfair increase in taxes under the AMT system for millions of Americans, many of whom can ill afford the increase and all of whom were never part of the AMT concept of paying your fair share that gave rise to the tax in the first place.

Allowing the increase in the exemption amount to “sunset” would directly increase the tax burden for many Americans past their “fair share” simply because they may live in a state with a higher than average state income tax. Others would pay more than their fair share simply because they have a larger than average family. Others would pay more than their fair share simply because they have higher mortgage interest due to a second lien necessary to fund their business or a child’s education. Clearly, none of these scenarios was the intent of the AMT from so many years ago.

The Alternative Minimum Tax exemption amount under Internal Revenue Code Section 55 was increased to \$70,950 for married taxpayers filing a joint return in 2009. For single taxpayers in 2009, the exemption amount is \$46,700. After 2009, those exemption amounts are scheduled to drop to \$45,000 and \$33,750, respectively. That represents more than a 37% decrease in the exemption amount for joint filers and a 27% decrease in the exemption for single taxpayers. As a direct result, potentially millions of Americans will be subject to Alternative Minimum Tax in 2010 that were not in 2009, without any change in their underlying earnings, deductions, exemptions or any other material economic factor. The bottom line is that these Americans, many of whom are small businesses, will pay more in tax without any corresponding increase in earnings. In other words, this would cause a direct and unintended tax increase on the very sector that we are all relying on to continue the economic recovery. At a very minimum, the exemption amounts should not be allowed to decrease, but should be increased annually based on an inflation index in order to continue the recovery.

Regardless of the net tax impact, the Alternative Minimum Tax System is still expensive to small business. Even if the AMT system does not result in any additional tax, it still must be calculated. The most common mistake related to AMT is simply not knowing that it needed to be calculated. The AMT requires a completely different set of rules and requirements for the tax calculation. The Committee has continually promoted the need for simplification in the Tax Code, yet here is a single topic that results in a whole new set of rules and regulations. In fact, a single topic that results in virtually a second tax

return, a second set of records, a second tax liability and a second set of headaches. The following is an excerpt from the Instructions for Form 6251, Alternative Minimum Tax – Individuals.

“Recordkeeping: For the AMT, certain items of income, deductions, etc., receive different tax treatment than for the regular tax. Therefore, you need to refigure items for the AMT that you figured for the regular tax. In some cases, you may wish to do this by completing the applicable tax form a second time. If you do complete another form, do not attach it to your tax return, but keep it for your records. However, you may have to attach an AMT Form 1116, Foreign Tax Credit, to your return; see the instructions for line 33 that begin on page 9.

For the regular tax, some deductions and credits may result in carrybacks or carryforwards to other tax years. Examples are investment interest expense, a net operating loss, a capital loss, a passive activity loss, and the foreign tax credit. Because you may have to refigure these items for the AMT, the carryback or carryforward amount may be different for the AMT than for the regular tax. Your at-risk limits and basis amounts also may differ for the AMT. Therefore, you must keep records of these different amounts.”

The very concept of having a second set of records, a second set of tax forms, a second set of calculations, goes to the very heart of the need for simplification. The original goal of the AMT system of targeting those higher income taxpayers who have the tax professionals on call to manage the paperwork and the multiple forms has some merit. Yet requiring small businesses, and more importantly average Americans, to keep up with two sets of tax issues borders on unconscionable.

Perhaps the best solution of all would be a total repeal of the Alternative Minimum Tax system. The NASE would support the repeal of the AMT system completely, based in part on the fact that it does not meet the original goals for which it was enacted, but more importantly because it results in a higher tax on small business both in money and in time. Even if no tax results from the AMT system, a system of requiring two sets of calculations is a tax itself. At a very minimum, the exemption amount that is included as part of the AMT should be indexed to inflation and maintained at a level consistent with the growth in earnings and expenses, and the adjusted amounts should not be allowed to revert to prior levels but should be extended.

Bonus depreciation options and Section 179 limits:

Investment in new business ventures as well as existing business ventures remains a critical factor in continuing the economic recovery. Providing incentives for such investment is also critical and should continue to be a focus of tax policy. Currently small businesses, as well as all businesses, can take advantage of additional first year depreciation for qualified property placed in service in the current year. A 50 percent

bonus depreciation in the first year is available, which directly affects the taxpayers' cash flow during that critical first year analysis of whether or not to invest in that new equipment. Unless extended, that option is scheduled to expire at the end of 2009 for most types of business property.

Likewise, the option to fully expense new investment in qualified property via Internal Revenue Code Section 179 is scheduled to be significantly reduced after 2009. Congress has recognized, and rightfully so, that the investment in business assets is critical to business growth, and corresponding tax policy to promote that investment must also be considered critical. Reducing the Section 179 limits would have the unintended consequence of reducing such investment and therefore, a corresponding reduction in the positive economic impact of such investment.

One key point to both items is that the impact from an overall tax standpoint is only one of timing. Neither the bonus depreciation nor the accelerated expensing option under Section 179 increase the deduction for the investment in total. Both simply accelerate the deduction to the year of acquisition, which more closely matches the cash flow commitment of the small business. Accelerating the depreciation directly helps in both the analysis for the small business in evaluating their ability to make the investment, and in the ability to fund the investment.

The tax code has always promoted investment, as has Congress and particularly this Committee. At a time when the economy needs investment to continue the recovery, extension of these provisions past the current year seems not only prudent, but necessary.

Conclusion:

The NASE supports the extension of expiring tax incentives including the AMT exemption, accelerated depreciation, sales tax deductions, first time home owner buyer credit and others. The key point for supporting the extension of tax incentives is to support extending the economic recovery. As always, small business is leading the way, supported by key proponents such as the House Committee on Small Business and the NASE. The recovery is underway and building steam. This is not the time to reduce the commitment to small business by reducing tax incentives.

The NASE believes in the long term impact small business will have on the overall economy, and supporting tax policy that promotes that impact is only natural. Promoting investment, encouraging new job development and keeping the playing field level for all taxpayers is essential to long term recovery. We are on the right path. This Committee, along with its stakeholders, is making a difference. The NASE strongly supports the continued investment in small business through tax incentives that have already proven effective and efficient. Extending the existing tax incentives makes sense in helping small businesses create jobs. Helping small businesses create jobs makes sense for helping the overall economic recovery. And helping the overall economic recovery makes sense for all Americans.